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Central Intelligence Agency



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8 May 1989

India-Nepal-China: Implications of the Trade Impasse

SUMMARY

The dispute between India and Nepal over trade and transit issues is unlikely to be resolved in the near term. Nepal's determination to assert its sovereignty and India's grievances over Nepal's seemingly "anti-Indian" policies are hardening the attitudes of both sides and will probably prevent a return to the status quo. While demanding Nepalese obeisance, India is not seeking to destabilize the Nepalese Government, and we see no immediate threat to the monarchy from civil unrest or from the military.

China is a factor in the crisis. In our view, New Delhi seeks to remind the Chinese that Nepal is in its sphere of influence, and Beijing wants to caution New Delhi not to allow the situation to go too far. Neither the Indians nor the Chinese, however, intend to let the issue impede the gradual improvement in their bilateral ties.

Tensions between India and Nepal, which have intensified over the past year, led to the failure in late March to renew trade and transit treaties. The Indians apparently concluded Nepal had been moving away from the "special relationship" defined by economic and political provisions in the Treaty of Peace and Friendship of 1950. Proof of this, in their view, was provided by Kathmandu's imposition of work permits on the 150,000 Indians living in Nepal, its efforts to give preferential treatment to Chinese commercial products, and its purchase of a small amount of Chinese arms and military equipment. In addition, New Delhi was annoyed with Kathmandu's

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continued lobbying efforts to make Nepal an international zone of peace. Already concerned about the Indians' regional intentions following their interventions in Sri Lanka and the Maldives, Nepal evidently interpreted demands regarding the treaties as a means for India to gain more say over Nepalese affairs. [REDACTED]

Implications for Nepal's Internal Stability

Nepal's economy has deteriorated since the treaties expired. Export earnings have decreased because Nepalese goods sent to India are now subject to stiff quotas, making them more expensive and, therefore, less competitive. As a result of India's closure of all but two of 15 border crossings--vital links in the overland transit of goods destined for Nepal--shipments of petroleum and third-country consumer items have dwindled. In addition, the output of Nepalese businesses and industry has slowed as a result of the virtual cutoff of Indian-origin inputs. Prices of goods in Kathmandu have risen in anticipation of future shortages. Revenues from tourism also have dropped, although the impact is moderated somewhat by the fact that the season peaks later in the year. [REDACTED]

Sporadic student demonstrations in Kathmandu have protested shortages of essential commodities and perceived government mishandling of the situation, but the Nepalese Government has been able to manage the unrest by increasing security measures. [REDACTED]

[REDACTED]

[REDACTED]

Despite the limited criticism against him, King Birendra continues to hold all the cards, in our view. [REDACTED] the Government of Nepal has begun to win more domestic support for its policy of "standing up to India" because few Nepalese want to be criticized as being "unpatriotic." The Nepalese military backs the King's decision and shows no inclination to move against him. In the unlikely event the military were to step in, we believe it would be as a last resort in support of the King. [REDACTED]

Impact on Sino-Indian Relations

Beijing's efforts to protect its relations with both sides in the impasse illustrate its reluctance to sacrifice hard-won advances in Sino-Indian relations over the past year. China's Foreign Ministry spokesman called in mid-April for Nepal and India to resolve their differences and resume normal trade. The Chinese probably fear a lengthy

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stalemate will undermine Nepal's political and economic stability and ultimately result in a surrender of much of Nepal's sovereignty to New Delhi. The remoteness of the Sino-Nepalese border and poor transportation links make it impossible for Beijing to fill the void left by India's cutoff, but China believes it must maintain at least token support for Nepal to underscore support for Kathmandu's--and other South Asian nations'--independence of action. [REDACTED]

Prime Minister Rajiv Gandhi also does not want the face-off with the Nepalese to set back Sino-Indian relations, although annoyance at Beijing's provision of materiel was a key factor prompting him to get tough with Nepal. [REDACTED]

[REDACTED] India and China are still planning to go ahead with the first meeting later this year of the Joint Working Group on the boundary issue. [REDACTED] no significant breakthrough is likely, but the agreement to hold the session suggests that India and China plan to work toward a final settlement and want to ensure peace and stability on the border. [REDACTED]

The Indians probably believe that Beijing's own constraints for assisting Nepal give them considerable latitude in pressing the Nepalese Government. New Delhi knows the lines of communication from Xizang Autonomous Region (Tibet) to Nepal are poor and that overland supply of even relatively small quantities of fuel and food items has been difficult for the Chinese. It is also aware that road conditions will worsen with the onset of the monsoon rains by July, and that traffic will probably be unable to get through from then until at least October. Perhaps more important, the Indians are probably banking on the continuing unrest in Lhasa to keep Beijing's troops in Tibet focused on maintaining the order there. [REDACTED]

In part because they believe China will do little on Nepal's behalf, Indian leaders apparently have ordered no special military precautions. They would probably view increased troop strength in Xizang as primarily related to China's maintenance of martial law there. Indian force deployments along the country's border with China have remained unchanged since tensions with Nepal increased. [REDACTED]

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Prospects for Talks

Neither India nor Nepal appears ready to engage in serious talks to end the trade impasse. Neither seems to have a clear understanding of what it or the other wants. Both sides have averred a willingness to discuss the problem, but their public remarks have been more likely made for domestic and international consumption. [REDACTED]

There is no consensus about what the main agenda will cover and who the key negotiators will be. [REDACTED] Kathmandu submitted a draft trade treaty with fewer concessions than in the previous accord. [REDACTED]

Nepal will probably try to sidestep talks until it can find a face-saving way to deal with India. It would probably perceive any Indian insistence that discussions begin with Birendra as an attempt by New Delhi to embarrass him and humiliate Nepal and would press for negotiations at a lower level. We believe it more likely that Nepal would agree to a meeting between Birendra and Gandhi only after subordinates on each side had worked through the differences and devised a draft treaty. [REDACTED]

Even if India and Nepal were to meet in the next few weeks, the negotiations would probably be prolonged. India seems intent on making Nepal "squirm" for a while. It apparently hopes to force acceptance of its terms on the trade and transit agreements: continuing Nepal's special trade status with India and unifying the treaties. More important, New Delhi wants to ensure that Kathmandu will think twice about pursuing closer ties with China, which India sees as a threat to its security sphere in the region. For its part, Kathmandu is prepared to hold out as long as possible to demonstrate that it is not subservient to India and to underscore that it must be treated as an "equal" in its dealings with the Indians. [REDACTED]

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Outlook

The risk of political instability will increase if the impasse continues for several more months. What are major inconveniences now could turn into severe hardships. The Nepalese in the vicinity of Kathmandu--the hardest hit because rural areas of the country are far more self-sufficient--would probably organize more protests. [REDACTED]

[REDACTED]

We judge that the trade impasse would challenge Birendra in a more indirect way over the long run. The dispute has heightened activity against the King by the outlawed political parties, which have long sought a more representative government. Birendra has managed to avoid significant liberalizing reforms in the past because these parties are weak and divided. Although we believe these groups would continue to lack the strength to topple the monarchy, they might gain additional support from Nepalese who see the King's inability to end the dispute quickly as a sign of ineffective leadership. We see little prospect for a groundswell of opposition activity that would threaten the King's staying power, but Birendra might concede some reforms to appease the moderate opposition. He might come to believe that by doing so, he could nip any concern that more radical groups would gain strength if he continued to ignore critics seeking a more participatory government. [REDACTED]

Nepal eventually will be obliged to conclude new trade and transit agreements because of the inescapable fact that its economy depends on access through India. Although there is a chance that the King could miscalculate the level of popular tolerance and jeopardize the monarchy, we believe the Nepalese Government will negotiate a new economic treaty with India before the situation gets out of hand. [REDACTED]

India, however, is unlikely to be as accommodating to Kathmandu as it was in earlier treaties. Nepal's apparent determination to pay the price of fewer Indian concessions in order to demonstrate its sovereignty and independence will hurt it economically because a new treaty will probably be less favorable. [REDACTED]

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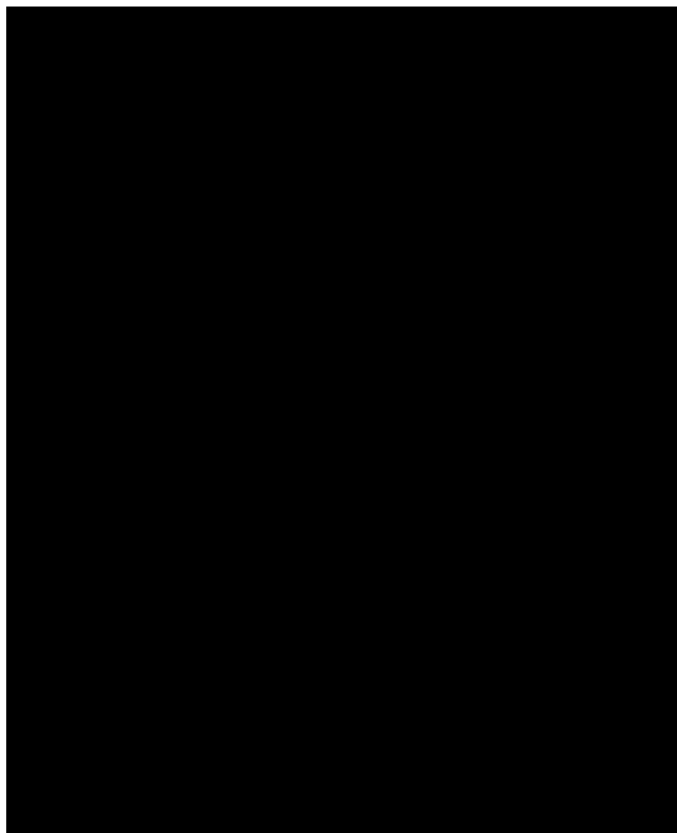
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